

Department of Housing and Community Development

Initial Statement of Reasons (ISOR) Uniform Multifamily Regulations and Amendments to Regulations for the Multifamily Housing Program, Joe Serna Junior Farmworker Housing Grant Program, and the HOME Investment Partnerships (HOME) Program

April 14, 2003

INTRODUCTION

This Initial Statement of Reasons (ISOR) provides conceptual and factual support for regulations (1) establishing uniform rules for multifamily rental housing developments assisted by three programs administered by the Department of Housing and Community Development (“HCD” or the “Department”), and (2) making other changes to one of the three programs, the Multifamily Housing Program, based on experience operating the program and recent legislation.

BACKGROUND / PURPOSE

BACKGROUND: Historically, the Department of Housing and Community Development (the “Department” or “HCD”) operated two major lending programs for lower income rental housing development – the Rental Housing Construction Program (RHCP) and the California Housing Rehabilitation Program for Rental Housing (CHRP-R). HCD also has two other programs that finance rental as well as ownership housing -- the federally-funded Home Investment Partnerships (HOME) Program (the “HOME Program”) and the Joe Serna Junior Farmworker Housing Grant Program (the “JSJFWHG Program”).

Effective January 1, 2000, the Legislature created the Multifamily Housing Program (MHP) which was intended to create an omnibus rental housing program combining, among other programs, RHCP and CHRP-R. In developing regulations for MHP, the Department had extensive discussions with prospective sponsors, borrowers and co-lenders of affordable housing projects.

The regulations for HOME and JSJFWHG represent the current thinking of their time, were tailored to work with the types of financing available at those times, and address the particular program’s unique project types. Some provisions of these regulations, however, are either outdated or do not reflect current HCD thinking. For example, the JSJFWHG Program regulations were drafted before the program was statutorily permitted to make loans and before

the current widespread use of tax credit financing. In addition, during its administration of MHP, the Department has found that some of the new policy regulations need further modification and that there are evolving policies that need to be embodied in regulation.

PROBLEM: Due to this historic evolution of programs and regulations, applicants for and recipients of assistance from the HOME Program, JSJFWHG Program and MHP often are subject to differing requirements regarding the same topic or issue. These unnecessary differences complicate application preparation and increase costs, because applicants and recipients must learn and administer multiple sets of rules. Since HCD itself administers its entire rental loan portfolio, these same differences increase the department's cost of program administration, and make it difficult to train staff and improve program processes and documents.

With respect to the MHP-specific amendments, the existing MHP regulations need revising to reflect one significant change mandated by SB 1227 of 2002. In addition, HCD has found through its experience that some provisions of the existing MHP regulations need clarification, are more complicated than necessary, or otherwise need improvement.

PURPOSE: The first purpose of these regulations is to bring uniformity, to the extent permitted by individual program statutes, to HCD's policies regarding acquisition, rehabilitation and/or construction of affordable rental housing projects; and to place those policies into a single set of regulations, rather than having them spread throughout its various multi-family program regulations. By placing these uniform regulations in a single location, it will make reference and understanding easier for customers and staff; and it will make it easier for HCD to update or add to these policies in the future, since it will not have to individually amend each program's regulations.

The second purpose of these regulations is to conform the regulations for MHP and JSJFWHG to the recent statutory changes and to make improvements to MHP based on program experience.

FACTUAL BASES: The factual bases for these changes come from HCD's long experience in administering affordable rental housing assistance, and from its more recent consultations with customers regarding potential changes in the MHP regulations.

RULEMAKING STRATEGY

Currently, HCD receives funding for the following three multifamily rental programs:

- Multifamily Housing Program ("MHP") (Chapter 7, subchapter 4, commencing with Section 7300; CCR Title 25, Division 1, Chapter 7, Subchapter 4, sections 7300 - 7336)
- Joe Serna Junior Farmworker Housing Grant Program ("JSJFWHG Program") (Chapter 7, subchapter 3, commencing with Section 7200; CCR Title 25, Division 1, Chapter 7, Subchapter 3, sections 7200 – 7238)

- Home Investment Partnerships Program (the “HOME Program”) (Chapter 7, subchapter 17, commencing with Section 8200; CCR Title 25, Division 1, Chapter 7, Subchapter 17, sections 8200 - 8219)

To make the proposed uniform rules applicable to the above three programs, this regulatory package amends each of the programs’ individual program regulations – generally by repealing an existing section and replacing it with a section incorporating the uniform regulation by reference.

Finally, this packages includes a number of MHP program-specific changes, including revisions to two definitions, modification of the rules limiting tenant rent increases, a substantial revision to the system for regulating developer fee and operating profit, modification of several application scoring criteria, and other changes..

PROPOSED REGULATIONS -- UNIFORM MULTIFAMILY REGULATIONS

Section: 8300. Purpose and Scope

Requirement or Necessity: It is customary and useful to the reader to begin a body of regulations with a statement of their authority, purpose and the general activities which they regulate. In this case the “purpose” subsection (a) also cites the statutory basis and authority for the program. HCD is authorized to adopt regulations pursuant to its general authority (Health & Saf. C. Sec. 50406(n), and for each specific program (JSJFWHG Program – Health & Saf. C. Sec. 50517.5(a); MHP – Health and Saf. C. Sec. 50675.1(c), 50675.3; HOME Program – 50896.1(b)).

Documentation, Study or Report: Existing regulations for 17 HCD loan and grant programs were surveyed. Sixteen have initial sections titled “General,” “Purpose,” “Scope and Authority,” “Purpose and Scope,” etc. These sections provide information similar to that in section 8300. Principal models are the regulations for the California Housing Rehabilitation Program (Rental) (CHRP-R, beginning with 25 CCR section 7670) and Rental Housing Construction Program – Proposition 84 (RHCP Bond, beginning with 25 CCR section 8075).

Alternatives Considered: None. Not to have a general introductory section would reduce the accessibility of the regulations and statutes to the user, and would have the benefit only of shortening the regulations by a fraction of a page.

Prescribed Actions, Procedures, Technologies or Performance Standards: None.

Fiscal and Economic Impacts: None

Section: 8301. Definitions

Requirement or Necessity: For general authority, see section 8300 above. It is essential that critical terms in regulatory language be defined to ensure uniform interpretation and application. Precise definitions help to avoid confusion and dispel ambiguity regarding program requirements, with the result that less customer and program staff time will be necessary to discuss and interpret the regulations. Where feasible, these proposed regulations employ definitions already in use by the department and understood by housing providers who are familiar with real estate lending industry practices and with other HCD programs.

Documentation, Study or Report: Most of the definitions in this section are identical to those in the existing MHP regulations which in turn were developed from RHCP Bond regulations (CCR Title 25, Division 1, Chapter 7, Subchapter 15), the MHP statutes (H&S section 50675.2), HCD's general statutes (H&S sections 50050-50105), and HCD's general regulations (CCR Title 25, Division 1, Chapter 7, section 6912 et. seq.).

Alternatives Considered: None.

Prescribed Actions, Procedures, Technologies or Performance Standards: None.

Fiscal and Economic Impacts: None. Some definitions refer to other provisions which may have economic impacts, but they will be discussed with the appropriate sections.

Discussion:

Note: Throughout the regulations, terms that are defined in this section are capitalized.

Subsection (a): “Assisted Unit” HCD-financed developments will typically incorporate both units renting at market rates and “assisted units,” for which rents and household income are limited under the terms of the regulatory agreement. This definition is used in regulatory provisions regarding permissible rents, tenant incomes and maximum loan amounts.

Subsection (b): “CalHFA” is the acronym for another state housing finance agency. It is used in the sections on required reserve accounts.

Subsection (c): “Commercial space” HCD-financed developments may be “mixed-use” – that is, they may incorporate commercial space along with residential units. This term is used in regulatory provisions addressing the presence of commercial space in a development.

Subsection (d): “CPI” This definition is used in the sections on replacement reserves and developer fee. Various forms of the Consumer Price Index are widely used in formulas for the calculation of future dollar amounts, to allow for the effects of inflation. The particular index selected here has been used to date by MHP. It is a broad measure of the general inflation level, and covers a geographic area large enough to avoid statistical aberrations common with more localized indexes.

Subsection (e): “Debt Service Coverage Ratio” This is a “term of art” used in the lending industry, where it has a reasonably standard meaning. This definition is consistent with that

meaning, and with the definition in the existing MHP, CHRP-R and RHCP Bond regulations. The definition excludes voluntary prepayments to ensure that sponsors may not artificially reduce their project's debt service coverage ratio (perhaps to conceal excess income) by making loan payments that are not required.

One use of this term, in the section on Underwriting Standards, is in a provision that specifies a maximum Debt Service Coverage Ratio. The intent of this provision is to require sponsors to secure as much amortizing debt as is reasonably available from private and semi-private lending sources. Generally, the amount of debt that a lender will loan is directly related to projected income for the project. However, there are some income sources that lenders do not consider to be available on a sufficiently reliable basis to count in their calculations (to underwrite). The final sentence of this subsection acknowledges this fact, and excludes income from the debt service calculation that cannot be underwritten.

Subsection (f): "Department" This is a short-form usage for the frequent references to HCD in the regulations.

Subsection (gi): "Developer Fee" This definition refers to the definition used by the California Tax Credit Allocation Committee for purposes of the Low Income Housing Tax Credit program, the largest current source of funding for low-income housing, and a major frame of reference for most users of HCD multifamily programs. By conforming the meaning of this term to that of the tax credit program, HCD is attempting to bring its program rules more in alignment with those of the tax credit program, and reduce confusion among program users.

Subsection (h): "Distributions" This term is used in the section on use of project operating income. It describes certain allowable payments to the sponsor out of this income. For financial planning and the integrity of projects it is necessary to define these payments. The first sentence makes it clear that earnings include nonmonetary as well as cash income, and that the limit applies to other entities with a financial interest in the project as well as the sponsor. The second sentence provides that the limit applies only to funds generated through operation of the project, and not to payments during the development phase, which will be governed by the section on Developer Fee. The second sentence lists some examples of payments that are not considered distributions. The third sentence lists other types of payments to sponsors or other parties that are considered to be distributions. These provisions are consistent with many other similar programs. This definition is identical to that in the existing MHP regulations, except that it excludes certain fee payments that are common in tax credit projects. This deviation from past MHP practice is being proposed to bring HCD's regulatory framework more closely in alignment with that used by local public agencies who provide supplemental funding for HCD projects, and hence reduce the cost and effort of loan document negotiation, regulatory compliance and monitoring.

Subsection (i): "Eligible households" This term defines who is eligible to live in units assisted by HCD programs. Since each of the three programs covered by these regulations has different statutory limitations on this subject, this term has multiple meanings.

Subsection (j): “Operating expenses” This term is used in a number of regulatory sections relating to rents, loan payments, budgets and similar financial matters. It is defined to mean expenses approved by the department, to ensure that the sponsor does not artificially inflate expenses as a way to circumvent program requirements. Eligible expenses are limited to recurring expenses, which excludes development and capital improvement costs incurred after the development period. Examples of eligible expenses and excluded expenses, consistent with customary usage, are given to clarify the definition. Costs for supportive tenant services, apart from on-site service coordinators, are excluded because these are social services, not housing activities, and are not subject to regulation by the program. This definition is identical to that used by the existing MHP regulations.

Subsection (k): “Operating income” This definition is identical to that used by the existing MHP regulations. It includes “all” income to prevent sponsors from holding out income that is not explicitly named. Inclusion of income from commercial space is necessary to accommodate mixed-use projects that can maintain fiscal integrity when considered as a whole, but that contain assisted units that show a loss when considered by themselves. The definition excludes tenant deposits, which are given back to tenants at termination of tenancy and cannot be used to offset expenses (except, in the case of security deposits, for certain cleaning and repair costs allowed by state landlord-tenant law). Payments received for tenant services are also excluded, consistent with the exclusion of tenant service costs from “operating expenses.”

Subsection (l): “Program” This is a convenient single-word name for frequent references to the Department funding program that is providing assistance to the project.

Subsection (m): “Project” It is necessary to define the term project for purposes of this program because of the many other interpretations of the term used by the housing industry, the financial industry, and tax and environmental law. This definition is identical to that in the existing MHP regulations (except that an unnecessary reference to “using Program funds” has been deleted) and includes virtually all aspects of a project that might be of concern in the making and administration of a loan.

Subsection (n): “Regulatory agreement” This term is used in a number of sections that specify rules applicable to operation of assisted developments. Regulatory agreements contain provisions regarding rent levels, maintenance, tenant selection, financial reporting, etc.

Subsection (o): “Rental housing development” This definition is consistent with the one in MHP statutes (H&S section 50675.2(d)), and with the similar definition used by the RHCP Bond program. This definition adds to those provisions by specifically excluding any “health facility” or “alcoholism or drug abuse recovery or treatment facility,” as defined. These are considered to be primarily treatment and service facilities rather than housing. They are not, for example, subject to standard landlord-tenant law in relations with their residents. HCD believe that the excluded types of facilities can and should seek funding from other, more appropriate sources.

This definition is the same as the one contained in the existing MHP regulations, except that an exception is made to the 5-unit minimum size requirement for HOME projects. MHP and JSJFWG exclude projects with fewer than 5 units because they provide assistance directly from HCD to project sponsors statewide, and it is not cost-effective for them to process and monitor

very small projects. HOME , on the other hand, provides funds in part through local public agency intermediaries, which allows for more cost-effective administration of these projects.

Subsection (p): “Restricted unit” This definition is identical to that in the existing MHP regulations. It is necessary because many HCD-financed projects will also include assistance from other sources such as tax credits, and will be subject to regulatory constraints imposed by the other programs. Tax credit rules may impose restrictions on units in a project that are not considered to be assisted, as well as on those that are. .

Subsection (q): “Rural area” This term is used in the section of these regulations on developer fees. It is also used by MHP to allocate a certain percentage of funds to rural areas. It is necessary to define because there is more than one definition of rural in state and federal housing laws. The proposed definition is the same as the one in the existing MHP regulations, and the same as the one used by the tax credit program.

Subsection (r): “Sponsor” This is an essential definition of the entity HCD does business with.. The term is necessary for the planning and implementation of the basic assisted housing finance transactions employed by HCD. The proposed definition is the same as the one in the existing MHP regulations.

Subsection (s): “TCAC” This is the standard acronym (pronounced “tee-kak”) for the frequently mentioned Tax Credit Allocation Committee.

Subsection (t): “Transitional housing” This term is used in the section on rental agreements. This is a relatively recent form of assisted housing, that has evolved as housing and social service agencies have learned more about the problems of homeless people, refugees from domestic violence, people emerging from institutions and other similar groups, and about what kinds of housing and supportive services are most successful at restoring their ability to function in the mainstream. The purpose of specifying that the scheduled term of stay in transitional housing may not be less than 6 months is to differentiate this form of time-limited housing from emergency shelters.

Subsection (u): “Unit” This term is used throughout the regulations. It is necessary to define it to distinguish between the residential housing units that are the subject of these programs and other types of units, including hotel units and commercial space units.

Section: 8302. Restrictions on Demolition

Requirement or Necessity: A primary objective of HCD’s programs is increasing the supply of housing. For this reason, it has traditionally avoided funding projects that resulted in the reduction of supply. This section is necessary to avoid this activity.

Documentation, Study or Report: This section is based on an existing MHP regulation (section 7302) and federal HOME rules, as specified in Section 104(d) of the Housing and Community Development Act of 1987.

Alternatives Considered: None.

Prescribed Actions, Procedures, Technologies or Performance Standards: This section prescribes a standard for assessing whether the supply of housing is being reduced..

Fiscal and Economic Impacts: None.

Discussion:

This section reflects HCD policy that housing development projects should not cause the net loss of viable existing housing. It is based on the current federal HOME rule on this subject, which prohibits a reduction in bedroom count. The proposed policy represents a change for MHP, which currently prohibits a reduction in unit count. The proposed policy allows replacing many small units with fewer large units, which allows projects to better serve the high need population of large families. Because of this, HCD believes that it represents an improvement over the current MHP regulation.

Section: 8303. Site Control Requirements

Requirement or Necessity: To ensure that an applicant will actually be able to develop a rental housing development on the site they propose for this purpose, it is common for housing finance programs to require legal control of the project site as a condition of application. These provisions, which specify the precise nature of the required site control, are based on HCD's experience with similar past programs, especially HOME, MHP, CHRP-R and RHCP.

Documentation, Study or Report: This section is based on the existing MHP and HOME regulations.

Alternatives Considered: None.

Prescribed Actions, Procedures, Technologies or Performance Standards: The section establishes a performance standard for evaluating whether an applicant has sufficient legal control of the project site to ensure that it will be able to develop the project as proposed..

Fiscal and Economic Impacts: No adverse impacts are imposed.

Discussion:

The forms of site control specified in this section are nearly identical to those required by HOME and MHP, and specified in the existing MHP regulations. The main differences between the two programs, as they now exist, are (1) the required duration of option agreements submitted at the time of application and (2) treatment of an exclusive negotiating right with a public agency.

HOME requires that options last at least 6 months from the anticipated date of award of program funds, while MHP requires only 3 months. This proposed regulation requires only that the option be valid through the anticipated award date. The objective of this change is to reduce the cost of options to applicants. It is based on the experience of both programs that applicants are generally able to negotiate option extensions once they receive a commitment of program funds, and are therefore able to provide greater assurance to the seller of the project site that they will eventually be able to consummate the purchase transaction.

MHP currently accepts possession of exclusive negotiating rights with a public agency as a valid form of site control, provided that the major terms of the transaction have been agreed to, while HOME requires that a complete final agreement be in place. MHP adopted the more liberal approach in recognition of the lengthy process public agencies often go through between the time they reach substantive agreement with a developer and when they complete the formal legal process required before they enter into a final agreement. MHP has not lost any projects as a result of this approach, and hence it is being adopted in these regulations.

Section: 8304. Unit Standards

Requirement or Necessity: For MHP, Health & Safety Code (hereinafter referred to as “H&SC”) section 50675.8 requires a regulatory agreement that, among other things, governs tenant selection, occupancy agreements, maintenance of affordable rents, and includes other provision as necessary to carry out the program, and H&SC section 50675.1(c) requires HCD to establish terms upon which loans may be made, consistent with the statutes. For JSJFWHG, H&SC section 50517.5(d)(4)(A) requires there be a written recorded agreement to secure performance under the grant or loan; and H&SC Section 50517.5(e)(2) allows HCD to supervise the operation and maintenance of assisted housing. For HOME, 24 CFR Section 92.252(e) requires that affordability restrictions be imposed by deed restriction or covenants running with the land. By regulation (section 8214(b)(3), HCD has chosen to accomplish this through a recorded regulatory agreement that also governs the operation and maintenance of the Project. Also, 24 CFR Section 92.504(c) requires that written agreements HCD enters into with HOME recipients must address certain subjects, including affordability and eligibility.

Documentation, Study or Report: Program experience has indicated the value of avoiding significant differences between assisted and nonassisted units in a mixed-income project. The benefits include the avoidance of income-related social stigma, the reduction of NIMBY (Not In My Back Yard) reactions to projects, and the flexibility of unit designations to ease administration of the project.

Alternatives Considered: Allow segregation of, and lower standards for, assisted units in HCD projects.

Prescribed Actions, Procedures, Technologies or Performance Standards: The section requires that units of similar bedroom numbers in a project should not be substantially different in design, size or amenities from non-restricted units.

Fiscal and Economic Impacts: It might be less expensive to build mixed-income projects with assisted units of lower standard than the market units, but such a project would incur significant disadvantages in terms of local acceptance, operational flexibility and equity for tenants of assisted units.

Discussion:

Subsection (a) is identical in substance to MHP's provision on this subject. It requires that restricted units, and units with differing income restrictions, shall not differ substantially in size or amenities from nonrestricted units with the same number of bedrooms, nor shall units be segregated by restriction or income level. This avoids segregation by income. It also facilitates the transfer of units from one category to another, as needed to accommodate tenants' change of income status, and lets the project management offer whatever units may happen to be vacant to applicants who help to fill current shortfalls in the project's income profile.

Subsection (b) is also identical to MHP's provision on this subject. It requires the number and characteristics of assisted units to be no less than provided in the regulatory agreement. This requirement exists for the full loan term. This is to prevent sponsors from circumventing the regulatory agreement by only adhering to its requirements for a limited period.

Subsection (c) requires the number of assisted units to equal the number of restricted units to the extent allowed by the requirements of Article XXXIV of the State Constitution. It is identical to a provision in the existing MHP regulations, and applies only to MHP because only MHP funds units other than assisted units. Allowing the number of assisted units to be less than the number of restricted units is necessary in some cases to enable projects to meet the requirements of Article XXXIV if the jurisdiction has not passed an Article XXXIV ballot measure.

Section: 8305. Tenant Selection.

Requirement or Necessity: For MHP, H&S section 50675.8(a)(1) says the regulatory agreement for a project shall ensure occupancy of assisted units by eligible households of very low and low income for the term of the agreement. For JSJFWHG, H&SC section 50517.5(d)(5) requires HCD to regulate the terms of occupancy agreements, H&SC section 50517.5(a)(1) requires that assistance be provided for housing for agricultural workers and their families, and H&SC section 50517.5(d)(3) requires HCD to determine standards for, and control selection by grantees and borrowers, of tenants. For HOME, 24 CFR Part 92 contains a number of requirements the state is required to pass along to recipients of HOME assistance including matters affecting tenant selection (e.g., 92.303 [tenant participation plan], 92.350 [nondiscrimination] 92.351 [affirmative marketing and minority outreach].

Documentation, Study or Report: This section is based on section 7311 of the MHP regulations, which in turn is based on section 7682 of the CHRP-R regulations and section 8087 of the RHCP Bond regulations. The approach to managing tenant selection outlined in these regulations has proved successful over more than a decade of operation of hundreds of CHRP and RHCP projects.

Alternatives Considered: None

Prescribed Actions, Procedures, Technologies or Performance Standards: This section imposes performance standards for fair tenant selection and occupancy of HCD projects.

Fiscal and Economic Impacts: No adverse impacts are imposed. These requirements may impose slight additional costs on operations of HCD projects, but these are offset by the advantages of program compliance and uniformity of administration.

Discussion:

Subsection (a) requires sponsors to select only eligible households as tenants of assisted units using procedures approved by HCD. The procedures must include 1) criteria for evaluating tenant applications, that do not discriminate in any arbitrary or unlawful way; 2) a prohibition of any requirement for local residency; 3) a prohibition on local residency preferences, except under limited conditions; and 4) provisions for tenant selection that include:

- Selection of tenants based on order of application, lottery or other method approved by HCD;
- Notification of successful applicants, and an estimated date when a unit will be available;
- Notification of unsuccessful applicants, with the reason for their ineligibility and a description of their appeal rights;
- Maintenance of a waiting list;
- Provisions for targeting special needs tenants in accordance with the regulatory agreement, and
- Affirmative fair housing marketing procedures.

The main purpose behind this subsection is to ensure that applicants for assisted units are treated fairly. The demand for affordable housing exceeds the supply in most areas of the state, and project management may be subject to pressures for favoritism, or tempted by opportunities to grant tenancies to ineligible households.

Except for subsection 8305(a)(3), regarding local residency preferences, subsection (a) is identical in substance to its counterpart in the existing MHP regulations, section 7311(a). Subsection 8305(a)(3) is being added because local residency preferences are often proposed for Department-assisted projects, and existing regulations for programs affected by these uniform regulations do not address them.

Local residency preferences are favored by some local government agencies that provide supplemental funding to projects that receive Department assistance. They can readily be applied in a manner that makes them function as requirements. There are two reasons for limiting them. First, local residency preferences can have a discriminatory effect; giving a strong preference to applicants living in a particular geographic area often means severely limiting access to project units by members of particular ethnic or racial groups. Second, the Department believes that it is inequitable to use funds derived from taxpayers throughout California on projects that deny access, on a practical basis, to vast numbers of otherwise-qualified California

residents who happen to live outside the municipal jurisdiction in which a particular project is located.

In contrast to preferences for local residents, preferences for households who work near the project do further the State's policy objective of promoting a local balance between jobs and housing. To reduce the potential impact of local residency preferences, and to further the objective of promoting a reasonable jobs-housing balance, the proposed language for subsection 8305(a) allows local residence preferences only when accompanied by an equally weighted preference for households with jobs in the community. To reduce the potential for local preferences having a discriminatory effect, this subsection further limits the type of geographic area on which these preferences may be based. A preference for residents of a city is less likely to adversely impact particular ethnic or racial groups than a preference for residents of a particular neighborhood within the city.

Subsection (b) specifies minimum occupancy standards (the number of persons per unit, depending on the number of bedrooms). The standards proposed here are included in the existing MHP regulations. They are designed to limit underutilization of large units.

Section: 8306. Tenant Recertification

Requirement or Necessity: For MHP, H&S section 50675.8(a)(1) says the regulatory agreement for a project shall ensure occupancy of assisted units by eligible households of very low and low income for the term of the agreement. For JSJFWHG, H&SC section 50517.5(d)(5) requires HCD to regulate the terms of occupancy agreements, H&SC section 50517.5(a)(1) requires that assistance be provided for housing for agricultural workers and their families, and H&SC section 50517.5(d)(3) requires HCD to determine standards for, and control selection by grantees and borrowers, of tenants. For HOME, 24 CFR Part 92 contains a number of requirements the state is required to pass along to recipients of HOME assistance including matters affecting tenant selection (e.g., 92.303 [tenant participation plan], 92.350 [nondiscrimination] 92.351 [affirmative marketing and minority outreach].

Documentation, Study or Report: This section is based on section 7311 of the MHP regulations, which in turn is based on section 7682 of the CHRP-R regulations and section 8087 of the RHCP Bond regulations.

Alternatives Considered: None

Prescribed Actions, Procedures, Technologies or Performance Standards: This section imposes performance standards for continued occupancy of HCD projects.

Fiscal and Economic Impacts: No adverse impacts are imposed. These requirements may impose slight additional costs on operations of HCD projects, but these are offset by the advantages of program compliance and uniformity of administration.

Discussion:

Subsection (a) requires sponsors to recertify their eligibility annually in terms of income and family size. This is necessary to determine whether it is appropriate to have them move to a different sized unit.

Subsection (b) requires households who no longer meet the minimum occupancy standards of section 8505 to generally be relocated to smaller units, if and when these smaller units become available. This provision is intended to free up large units for use by large households.

Following the pattern set by Section 8505, it allows the Sponsor discretion to keep the household in their existing unit if special circumstances apply, such as a temporary reduction in household size.

Section: 8307. Rental Agreement and Grievance Procedure

Requirement or Necessity: While California law governs the legal relationships between landlord and tenant in general, this section sets forth the content of the rental agreement that relates to sponsor and tenant responsibilities under this program. The primary purpose of the affected programs is to provide housing to lower income renter households. To accomplish this it is necessary not only to build housing but to define the kinds of households that will be eligible to live there, and ensure that the housing is managed so that they *can* live there.

Subsection (a) governs the rental or occupancy agreement to be signed by the tenant. It is very similar to the provisions of the MHP regulations on this subject. These agreements must 1) list the reasons for which a tenant can be evicted; 2) promise the tenant a notice of any eviction proceeding, including the grounds for eviction; 3) inform the tenant of grievance procedures available to the tenant; and 4) provide notice that the tenant must annually recertify household income and size.

The emphasis here is on requiring the management to inform the tenant of his or her rights and obligations, including good cause for evictions. State landlord-tenant law does not require that reasons be given in an eviction notice. It is assumed that the management will take care to include the other legal elements of a rental contract.

Subsection (b) is also patterned after the existing MHP regulations. It requires the sponsor to adopt an appeal and grievance procedure through which tenants can challenge actions of the management before an impartial body. Tenants and applicants must receive copies of the procedure. These provisions tend to redress the natural balance of power that favors the management of a subsidized rental development. They also provide for informal ways to resolve conflicts, to prevent the escalation of conflict where possible. These requirements parallel those in RHCP and CHRP-R

Subsection (c) is identical to section 7311(c)(2) of the existing MHP regulations. It makes it clear that use of the project's appeals and grievance procedures does not limit a tenant's legal rights in any way.

Section: 8308. Operating Reserves

Requirement or Necessity: Program experience, and the experience of the affordable housing industry in general, has demonstrated the necessity for a stable rental housing development to have adequate operating reserves. Affordable housing developments, due to their low rents, do not generate much cash flow for payment of operating expenses and debt service. They have very little margin in the case of unanticipated vacancies or unexpected increases in operating costs (e.g., spikes in energy costs). Prudent operating reserves are necessary to assure the long-term financial stability of a development.

Documentation, Study or Report: The proposed reserve requirements are very similar to those required by the existing MHP regulations. The RHCP Bond regulations require funding of operating and replacement reserves (section 8102), and allow program funds to be used to capitalize the operating reserve (section 8079). Similarly, the CHRP-R regulations require periodic funding of both operating and replacement reserve accounts (section 7696).

The specific requirements in the proposed regulations regarding operating reserves are heavily influenced by the “best practices” listed in the October 1998 “Report of the National Council of State Housing Agencies Housing Credit Task Force,” and in the February 2000 “Best Practices for Asset Monitoring and Compliance Monitoring” published by the National Association of State and Local Equity Funds (NASLEF). The requirements regarding replacement reserves also derive from the requirements of the U.S. Department of Housing and Urban Development (HUD) for various federal housing programs, including the Section 202 and Section 811 programs.

Other sources reviewed include the “Rental Development Reserve Requirements” of the California Housing Finance Agency (CalHFA), the projected reserve deposits used by the California Tax Credit Allocation Committee (TCAC) in its analysis of project feasibility for purposes of the Low Income Housing Tax Credit Program (CCR section 10327), and the reserve requirements of various private lenders and equity investors, as described in loan documents and limited partnership agreements for projects that have received HCD funding.

Alternatives Considered:

One alternative would be to conform the uniform operating reserve requirements to those of HCD’s RCHP and CHRP-R programs (e.g., require operating reserves to be funded out of cash flow in an amount equal to three percent of operating expenses, as in RHCP). This alternative was rejected for two reasons. First, for financially healthy projects the standard used under previous programs sometimes resulted in excessive reserve accumulations over time. Second, because the operating reserve was funded exclusively from operating cash flow, some less healthy projects were never able to make adequate deposits. These projects, which often needed operating reserves the most, never built them up to the point where they were truly useful.

Another alternative would be to not require operating reserves on a standard basis, and to make a case-by-case determination for each project whether they were necessary and the required source and level of funding, taking into account the requirements of other funding sources and the particular characteristics of the project and the project sponsor. The case-by-case method was

the approach taken in the MHP guidelines that pre-dated the MHP regulations. It is not being proposed for these regulations because it proved too complex and open-ended for program staff to implement in a consistent manner.

Other alternatives would be to pattern HCD's operating reserve requirements after those of TCAC or CalHFA. TCAC, which does not provide funds to projects, does not require any particular levels of operating reserves, leaving the analysis of the need for them to the other funding sources.

CalHFA requires an "operating reserve" in a minimum amount less than that contemplated by the proposed regulations (10% of gross income vs. 4 months of operating expenses, replacement reserves and must-pay debt service), and requires three other similar reserves, with a total reserve funding that typically exceeds the proposed requirements. CalHFA allows the release of all funds in the operating reserve, and in the other similar reserves, after certain performance requirements have been met, but employs more conservative cash-flow underwriting assumptions than those proposed for HCD. The CalHFA model is not proposed as the HCD standard mainly because HCD believes that HCD's less conservative underwriting should be balanced by a long-term reserve requirement, and because its experience with other programs suggests that project cash flow during the early years of project operation is often a reliable source of reserve funding.

Prescribed Actions, Procedures, Technologies or Performance Standards: This section establishes certain procedures for the establishment and calculation of operating reserves

Fiscal and Economic Impacts: No adverse impacts are imposed. The section affects the operation of projects by sponsors who choose to obtain program funds.

Discussion:

The introductory paragraph requires the sponsor to establish an operating reserve to defray operating shortfalls resulting from unforeseen events. This subsection makes it clear that the requirements that follow do not apply to other types of operating reserves, such as those established to subsidize rents.

Subsection (a) requires advance HCD approval of withdrawals from the operating reserve. This follows the practice of past HCD programs, and is consistent with the NASLEF best practices recommendations. It is necessary to prevent owners from unauthorized use of these funds. Since timely access to operating reserve funds can be critical to sponsors, this subsection specifies that failure by HCD to act on a request after 30 days is deemed to constitute approval of the request, provided that the funds are used for an eligible purpose.

Subsection (b) specifies how the operating reserve must be funded and in what amount. The specifics of this requirement were drawn directly from the NASLEF best practices document.

Subsection (c) requires the operating reserve to be replenished from cash flow, if withdrawals are made. This requirement is necessary because project cash flow tends to fluctuate up and down, making long-term maintenance of reserves important

Subsection (d) provides a mechanism for reducing the required operating reserve balance, in cases where the project has generated adequate cash flow over a sustained period.

Subsection (e) gives HCD the option to defer to another lender on the details of reserve funding amounts and withdrawal procedures, provided that HCD's minimum requirements are met. In many projects there are several funding sources with an interest in project reserves, and allowing another source to set the operating reserve funding level and control withdrawals may adequately protect HCD's interest.

This subsection also grants the Department authority to exempt CalHFA projects from HCD requirements because of CalHFA's traditionally conservative underwriting and tight control of project reserves. It allows for the same exemption for HUD 811 and 202 projects because HUD essentially funds any operating shortfalls directly, eliminating the need for an operating reserve.

Subsection (f) is intended primarily to apply to projects completely financed by HOME. Due to federal rules restricting the use of funds provided under this program, these projects may not be able to capitalize a reserve in the amount required by this section. In that case, this subsection allows the reserve to be built up over time, using project cash flow as the funding source.

Section: 8309. Replacement Reserves

Requirement or Necessity: Program experience, and the experience of the affordable housing industry in general, has demonstrated the necessity for a stable rental housing development to have adequate replacement reserves.

Documentation, Study or Report: The proposed reserve requirements are very similar to those required by the existing MHP regulations. The RHCP Bond regulations require funding of operating and replacement reserves (section 8102), and allow program funds to be used to capitalize the operating reserve (section 8079). Similarly, the CHRP-R regulations require periodic funding of both operating and replacement reserve accounts (section 7696).

The specific requirements in the proposed regulations regarding operating reserves are heavily influenced by the "best practices" listed in the October 1998 "Report of the National Council of State Housing Agencies Housing Credit Task Force," and in the February 2000 "Best Practices for Asset Monitoring and Compliance Monitoring" published by the National Association of State and Local Equity Funds (NASLEF). The requirements regarding replacement reserves also derive from the requirements of the U.S. Department of Housing and Urban Development (HUD) for various federal housing programs, including the Section 202 and Section 811 programs.

Other sources reviewed include the "Rental Development Reserve Requirements" of the California Housing Finance Agency (CalHFA), the projected reserve deposits used by the

California Tax Credit Allocation Committee (TCAC) in its analysis of project feasibility for purposes of the Low Income Housing Tax Credit Program (CCR section 10327), and the reserve requirements of various private lenders and equity investors, as described in loan documents and limited partnership agreements for projects that have received HCD funding.

Alternatives Considered:

The proposed replacement reserve requirement is similar to those used by HUD, RHCP-Bond and CHRP-R. An alternative would be to use the requirements recommended in the best practice documents mentioned above, which are consistent with CalHFA's requirements and the standards used by TCAC in its evaluation of project feasibility. This alternative would typically result in lower deposit amounts. It was rejected because HCD's experience with its existing portfolio suggests that these deposit amounts are inadequate to provide for the replacement needs of projects over the full 55-year term of the loan.

Another alternative would be to adopt the requirement of the Rural Housing Service (RHS) of the U.S. Department of Agriculture, another federal funding source with a large portfolio of projects that have been in operation for many years. RHS requires annual funding in an amount that, on a percentage basis, substantially exceeds that proposed for MHP (1.0 % of total development cost less land cost vs. 0.6% of the cost of structure construction). RHS reports that, even with funding at this level, a large proportion of its older projects are not able to meet their replacement needs.

HCD is not adopting the RHS formula because 1) costs for mostly urban MHP projects are typically substantially higher than for RHS projects, which will tend to reduce the difference between the two standards, and 2) these proposed regulations grant HCD the authority to increase replacement reserve requirements over time, which should allow for adjustments if necessary.

Discussion:

The introductory paragraph requires establishment of a replacement reserve, and describes its purpose.

Subsection (a) requires advance HCD approval of withdrawals from the replacement reserve. This follows the practice of past HCD programs, and prevents Sponsors from using reserve funds for other than the intended purpose. Consistent with the provisions of Section 8308(a), the parallel subsection governing withdrawals of operating reserves, this subsection deems sponsor requests approved if they have not been acted on by HCD after 30 days, provided that the use of funds is an eligible use.

Subsection (b)(1) applies to new construction projects, and specifies both how the replacement reserve is to be funded and minimum funding amounts. The proposal is to set the minimum annual deposit amount at 0.6% of the cost of constructing the structures, unless there is definitive evidence (generally a study of the specific building being constructed by a third-party expert) that suggests a different amount. HUD has used the 0.6% standard for a number of years for

several of their mortgage insurance and direct loan programs. It is also the requirement used in several HCD programs, including MHP and RHCP-Bond.

Subsection (b)(2) specifies reserve requirements for rehabilitation projects. For these projects, the need for replacement reserve funds vary widely, based on the remaining life of the various building components and the cost of replacing them, and does not correlate to the cost of construction. These regulations therefore require that a study of the actual physical needs of each rehabilitation project be conducted, and that reserve deposits be sized based on this study.

Subsection (b)(3) allows HCD to adjust required replacement reserve deposit amounts over time, based on reliable indicators of changes in the need for deposits. HCD needs this authority because of uncertainties in future inflation rates, replacement costs, the actual performance of building components, and other factors. Over the 55-year loan term, these uncertainties become quite large.

Subsection (b)(4) gives HCD the option to defer to another funding source on the details of reserve funding amounts and withdrawal procedures, provided that HCD's minimum requirements are met. Typically, other funding do not have the same long-term interest in this subject as HCD, so it is anticipated that this provision will be used sparingly. There may be cases, however, where other funding sources do share HCD's interest, and deferring to them would eliminate duplicative controls.

As with operating reserves, HCD proposes to grant itself authority to defer to CalHFA on the general subject of replacement reserve funding due to their conservative underwriting, to HUD because HUD precludes control of reserves by other funding sources, and to RHS because, as noted above, of this agency's higher replacement reserve requirements.

Section: 8310. Underwriting Standards

Requirement or Necessity: H&S section 50675.7(b)(3) requires a proposed MHP project to be feasible, and requires this to be a minimum threshold requirement of the MHP project selection process. HCD program experience leads to the belief that certain provisions and conditions in the financial structure and operating rules of a rental housing project will greatly improve the project's probability of success. This section requires HCD to use a number of these provisions as assumptions when analyzing a projected project's feasibility – and thereby ensures that they will become part of the actual project's operations. Neither the HOME statutes nor the JSJFWHG Program statutes expressly address financial feasibility. However, the rental projects funded by these programs do not differ from those funded by MHP, and therefore, there is no reason that the underwriting assumptions should differ among these three programs. Moreover, all three programs require projects to provide affordable housing over a period of time in excess of the conventional mortgage term of 30 years (usually 55 years). The effects of assumptions made at the underwriting stage, be they accurate or inaccurate, will be greatly magnified over this extended period of time. It is therefore extremely critical that assumptions be on the conservative side to better assure that a project can survive for its lengthy period of affordability

Documentation, Study or Report: Most of the proposed provisions are identical or very similar to the comparable provisions of MHP or HOME. The CHRP and RHCP regulations do not gather provisions regarding project feasibility into a single section like 7319. Information similar to that listed in section 7319 is required in various parts of the prescribed CHRP and RHCP application forms.

Alternatives Considered: None.

Prescribed Actions, Procedures, Technologies or Performance Standards: This section adopts a number of standards to be used in evaluating project feasibility. It adopts by reference TCAC regulatory standards for estimating project operating expenses (subsection c), with authority to HCD to modify the results if justified by specific project-related factors.

Fiscal and Economic Impacts: This section shapes the feasibility analysis for a proposed project, and influences its sponsor's chances of receiving funding.

Discussion: This section establishes certain assumptions that HCD is required to use when analyzing the feasibility of a proposed project:

Subsection (a) provides that the project's vacancy rate will be assumed to be 5 percent, unless market evidence supports a different figure or another funding source requires use of a different assumption. These assumptions are necessary for calculations to project the project's cash flow – an important factor in overall feasibility. Five percent is the standard assumption used by nearly all funding sources, although some require a different assumption for special situations (e.g. TCAC requires 10% for special needs projects), or will relax the 5% assumption in certain markets.

Subsection (b) provides that vacancy rates for commercial space will be assumed to be 50 percent. HCD program experience indicates that commercial space utilization in conjunction with lower income housing has produced higher than normal market vacancy rates in the commercial space. Since vacancy rates fluctuate with real estate market cycles, the 50 percent figure reflects HCD's concern that a financial drain on the project due to high commercial vacancy rates should not compromise the primary housing purpose of the project. In practice, loss of a tenant in the small commercial portion of a mixed-use project often means that a significant portion of the commercial space becomes vacant, and there is often a long period of vacancy before a new tenant can be found.

Subsection (c) requires that minimum operating expenses be assumed to be no lower than those listed in certain specified TCAC regulations. These calculations are influenced by unit size, project density, and rural or urban project location, and consideration is made for either family or senior status of the occupying household. HCD is authorized to use higher assumed operating expenses if warranted by experience with comparable properties and particular project characteristics, such as the nature of the tenant population or the degree of rehabilitation planned. HCD may also approve lower operating expenses than those specified in the TCAC regulations if the project has features such as its own electrical generating system that result in quantifiable operating cost savings, as documented by a qualified third party. HCD is not authorized to

reduce operating expense assumptions for bond-financed projects, as allowed under the TCAC regulations. TCAC allows this reduction because many of its bond-financed projects are very large and have a relatively low proportion of poor people, characteristics which tend to reduce operating costs. HCD financed projects rarely share these characteristics, and hence allowing the reduction is inappropriate.

This section provides HCD with a tested standard for evaluating projected operating expenses – the TCAC regulations – but also with the necessary flexibility to judge and, if necessary, adjust the results, which depend heavily on factors influenced by the time, location, and specific features of the proposed project.

Subsection (d) requires operating expenses and management fees to be within the normal market range. It is aimed in part at limiting the ability of Sponsors to inflate profit levels by inflating fees taken for performing property management functions. HCD will periodically survey existing projects, management companies, etc., to determine the current market range. This is another instance of a parameter that must be determined at the time, according to current conditions.

Subsection (e)(1) provides that the project's first-year debt service coverage ratio (defined in the definitions section) must be no less than 1.10 to 1. This means that projected cash flow income available to pay debt service for the project must be at least ten percent greater than the total debt service payment obligation. (Projects receiving federal Section 811 or 202 funds are exempted because HUD does not allow cash flow in excess of operating expenses and debt service. The HUD subsidy provides the operating cushion.)

This is a prudent safety margin that HCD believes is justified by program experience. As housing markets fluctuate, rental housing developments often experience revenue flows below projected levels that endanger the project's ability to operate and pay its mortgage and other credit bills. If not corrected, or avoided by policies like this one, this situation can lead to default, workout arrangements, or foreclosure. If this provision leads to income greater than needed to pay project obligations, the surplus can be applied to reserves, to debt reduction, or allowed as distributions to the sponsor and partners.

Subsection (e)(2) limits the first-year debt service coverage ratio to 1.20 to 1, with certain exceptions. This limit allows a reasonable level of cash flow for a publicly subsidized project while also allowing private financing to effectively underwrite a project and participate with long term financing. Net cash flows in excess of 1.20 to 1 are generally accepted in the assisted housing industry as an indicator that a project has the capacity to support additional private market rate debt. This additional private debt reduces the amount of development subsidy necessary from the Departments funding programs. It is the Departments policy, and a requirement of the HOME program, that no more than the necessary amounts of program funds are invested in any one project to provide affordable housing. This ensures long term financial stability of projects while limiting undue enrichment of project sponsors. This section also encourages additional private investment and allows the Department to participate in a greater number of affordable housing projects. This subsection provides an exception to the 1.20 debt service coverage ratio limit to address the situation of projects with very low rental income and, consequently, very low levels of supportable debt service. For this set of projects, debt service

coverage provides a misleading measure of the cash flow “cushion” available to absorb operating shocks; high debt service coverage ratios can be associated with minimal cash flow, leaving projects vulnerable to unexpected increases in operating costs, operating cost inflation outpacing income growth, and similar occurrences. A better measure of financial viability is provided by comparing projected cash flow to operating expenses. Based on department experience, a cash flow cushion in the amount of 12 percent of operating expenses is generally adequate to provide the necessary cushion. For a typical project with very low rental income, it is also similar in magnitude to the cash flow allowed under the regulations of the department’s main rental housing finance program, the Multifamily Housing Program.

Subsection (f) requires that all mandatory debt service must be payable from projected cash flow, except for balloon payments that pose a low threat to project feasibility. The absolute prohibition on balloons on loans senior to HCD’s derives from the fact that these loans pose the greatest threat to HCD’s loan security.

Subsection (g) requires variable rate loans to be underwritten at their maximum possible interest rate unless the Department determines that using a lower interest rate will not threaten feasibility. It addresses the risk associated with increasing interest rates, while providing the Department with the flexibility required to address variable-rate financing structures that may limit interest-rate risk through mechanisms other than interest rate ceilings.

Subsection (h) requires income and expenses to be extrapolated for 15 years in accordance with TCAC regulations. If income includes rental assistance or operating subsidy payments under a renewable contract, it will be assumed that this contract will be renewed, where the renewal is likely. HCD needs the flexibility allowed by this provision to adjust its underwriting based on changes over time in the policies of rental assistance and operating subsidy programs.

Subsection (i) requires underwriting based on the reserve requirements specified in the sections on operating and replacement reserves. These sections allow (in the case of new construction) and mandate (for rehabilitation) replacement reserve requirements to be based on project-specific studies that are generally completed after the initial feasibility determination is made during the application period. As a consequence, the Department needs to use estimates of the ultimate requirements for the initial feasibility review.

Subsection (i)(1) specifies the limits on application-period replacement reserve deposit assumptions for new construction. For new construction projects with high construction costs, it is expected that third-party studies will often demonstrate a need for replacement reserve funding that is less than the 0.6% standard. For this reason, the last portion of subsection (b)(1) allows HCD to base its initial underwriting on a preliminary estimate of the required deposit amount, ranging between a certain per unit (\$400 with an inflation adjustment) and the standard assumption. MHP has used the \$400 plus inflation adjustment figure at the initial underwriting stage.

Subsection (i)(2) specifies the lower limit on application-period replacement reserve deposit estimates for rehabilitation projects, using the same \$400 plus inflation figure as MHP. Since the

replacement needs for this type of project varies greatly based on the scope of the rehabilitation, and can be quite high, no upper limit is specified.

Subsection (j) requires underwriting of construction loans based on specified minimum levels of funds budgeted for construction cost over-runs. The five percent specified for new construction is reasonably standard in the lending industry, and is the figure currently used by HOME. The industry generally uses a higher number for rehabilitation projects, where the potential for surprise is greater. The ten percent assumption specified here is current HOME practice.

Section: 8311. Limits on Development Costs

Requirement or Necessity: For MHP, H&S 50675.7(b)(2) says that development costs for a proposed project shall be reasonable compared to costs of comparable projects in the local area. For HOME, 24CFR92.250 requires that HOME funding be kept to the minimum necessary amount, which in turn requires that development costs be reasonable. To avoid unnecessary expenditure of public funds, nearly all programs of this nature have some sort of check on project costs.

Documentation, Study or Report: Subsection (c) and (b) are copied directly from subsections 7314(b) and (c) the existing MHP regulations. Subsection (a) is a simplified version of 7314(a). Subsection (d) is based on a similar provision adopted by the Rural Housing Service of the U.S. Department of Agriculture for purposes of that agency's Section 515 program (and found at section 1944.215(a)(5) of RD Instruction 1944 –E).

Alternatives Considered: An alternative would have been to adopt in full the provisions in MHP regarding specific prohibited design features. In practice, however, these provisions have proved of limited use. In addition, it may be more productive to control costs through a focus on total development costs, rather than at individual design features.

Prescribed Actions, Procedures, Technologies or Performance Standards: This section sets standards for project development costs.

Fiscal and Economic Impacts: This section is intended to control the development costs of assisted rental housing projects.

Discussion:

Subsection (a) requires project costs to be in line with costs experienced in other similar developments. This is the standard method for evaluating costs of this nature, which vary widely from location to location and over time. The qualified "of modest design" is intended to make it clear that the developments analyzed for this purpose must not be of luxury quality or have exotic design features.

Subsection (b) provides that builder overhead and profit will be limited, and other general requirements will apply, in accordance with TCAC regulations.. This provision helps to implement HCD's intention that MHP will work smoothly with the tax credit program. The

TCAC limits adopted by reference are time-tested and will be familiar to most affordable housing developers.

Subsection (c) states that property acquisition prices may not exceed appraised value, unless any increment above appraised value is fully covered by other public agency financing that is junior to the MHP loan and that carries no mandatory debt service. This is to limit the circumstances under which sponsors pay a premium for land, above and beyond its fair market value, and hence increase the public subsidy required. An allowance is made for above-market purchases driven by local public agencies, which sometimes elect to pay a premium price in order to redevelop parcels that would otherwise be unavailable.

Subsection (d) addresses the situation where unusual site development costs are not compensated for by a commensurate reduction in land cost. This provision is closely modeled on the Rural Housing Service rule identified above under the “Documentation, Study or Report” heading. It is intended to prevent sponsors from paying more than the true market value for land that requires extensive site improvements. It is also designed to discourage local governments from imposing requirements that create substantial site development costs.

Section: 8312. Developer Fees for Projects with LIHTC.

Requirement or Necessity: Regulation of fees is necessary to prevent profit levels above and beyond what is needed as an incentive for sponsors to develop the housing and operate it appropriately. For MHP, H&S 50675.5(b)(5) lists “reasonable developer fees” as an eligible MHP cost. H&S 50675.8(a)(5) says the regulatory agreement shall permit a sponsor to distribute earnings in an amount established by the department and based on the number of units in the development. Fees and operating profit provide a necessary incentive for project development and proper operation. Neither the HOME statutes nor the JSJFWHG Program statutes expressly address developer fees. However, the rental projects funded by these programs do not differ from those funded by MHP and therefore, there is no reason that all three programs should not be subject to the same limitations on developer fees

Documentation, Study or Report:

The existing MHP regulations limit developer fee in a manner similar to that proposed for these regulations. RHCP-Bond regulation section 8090 limits net developer fees to 25% of net syndication proceeds. TCAC regulations limit both developer fees and distributions made from operating income. Several major local jurisdictions, including Los Angeles, San Francisco and Oakland, have policies on this subject as well. The existing MHP regulation, and the one proposed here, is patterned after the local jurisdiction models.

Alternatives Considered:

TCAC’s limits are based primarily on taxable basis (cost, roughly) and, for very large projects, unit count. For projects that are receiving tax credits, the proposed regulation is consistent with TCAC’s, with some important differences.

First, TCAC does not distinguish between fees paid from development funding sources and fees paid through operating cash flow over time (“deferred” fees). The proposed regulation sets the maximum fee at the level allowed by TCAC, but limits the amount paid from development funding sources to what is often a lesser amount. The reason for varying from the TCAC standard on this point is that HCD believes it does not need to offer developers the level of up-front fees possible under the TCAC regulations to obtain sufficient high quality applications to use the amount of HCD funds that are available. This belief is supported by the experience of MHP, which has employed a very similar fee regulation system, and has been oversubscribed.

Second, the TCAC framework does not make any adjustments for contributions to the project made by the developer that offset fees taken. HCD would like to encourage such contributions (which increase the amount of tax credit equity raised without unduly enriching the project developer), and hence exempts them from the limit proposed here.

Third, by linking allowable fees directly to project costs, TCAC arguably provides an incentive to increase costs. To avoid this incentive, HCD is proposing to base allowable up-front fees on unit count rather than project cost.

Prescribed Actions, Procedures, Technologies or Performance Standards: This section sets standards and procedures for calculating developer fees.

Fiscal and Economic Impacts: These rules limit sponsor fees..

Discussion:

Subsection (a) allows total developer fee in the amount recognized by TCAC for inclusion in the tax basis of the project. For many projects, this limit exceeds that allowed under the existing MHP regulations, which limit this fee based on a schedule tied to unit count, and do not allow deferred fees in excess of this amount. This change from MHP would allow developers of projects whose basis was formerly constrained by the MHP limit to qualify for a higher basis, and thus attract more equity to the project.

Subsection (b) puts a cap on total net developer fee payable during the development period. Except for last provision, regarding deferred fee, this subsection is identical with its counterpart in the existing MHP regulations. Following the pattern set forth in the MHP statute regarding limits on distributions, the proposed cap on developer fee is based on the number of units in the project. It also varies based on the extent of the construction work

The development-period limit applies to “net developer fee,” which is defined in subsection (c) to exclude fee amounts offset by sponsor contributions of funds or real property. This provision is designed encourage such contributions, which result in extra equity being generated without increasing the Program subsidy required for the project.

Subsection (d) clarifies that deferred developer fee (fee that would have been paid from development sources if these sources were available in larger amounts, but is instead paid out

over time from cash flow) can be paid from cash flow in accordance the section that regulates cash flow.

Overall, the regulatory schedule proposed in this section is based on the limits on developer fees adopted by several large local jurisdictions with active housing programs. By tying allowable fees to the number of units produced, rather than their cost, it attempts to avoid incentivizing high development costs, and to encourage larger projects that benefit from economies of scale. At the same time, it allows higher average per-unit fees for small projects, because for certain populations and in certain situations small projects are often appropriate, and the sponsor's costs are not strictly proportional to project size. For these small projects, the proposed regulations allow generally higher fees than certain local agencies, such as the Los Angeles Housing Department.

As an incentive for projects that add to the housing stock, the per-unit limits are set at a relatively high level for new construction and substantial rehabilitation projects, at a lower level for moderate rehabilitation projects, and at a minimal level for projects that involve just acquisition and minor rehabilitation.

Section: 8313. Developer Fee for Projects without LIHTC

Requirement or Necessity: See explanation for the previous section. This section covers the same topic, but for simplicity's sake covers another set of projects.

Documentation, Study or Report: See explanation for the previous section.

Alternatives Considered: See explanation for the previous section.

Prescribed Actions, Procedures, Technologies or Performance Standards: See explanation for the previous section

Fiscal and Economic Impacts: See explanation for the previous section

Discussion:

Subsection (a) specifies that the same maximum fee schedule applicable to net developer fees for tax credit projects generally applies to non-tax credit projects.

Subsection (b) modifies the general rule by allowing a flat \$5,000 per unit maximum net fee for projects that receive their primary funding under the federal Section 811 and 202 programs in non-rural areas. These programs have been long over-subscribed, and more generous state incentives are unnecessary to ensure adequate demand for them. Section 811 and 202 projects, which would otherwise typically be eligible under MHP for the fees allowed new construction or substantial rehabilitation projects, have traditionally been completed without developer fees of any kind, by sponsors that relied on consultants to perform most of the development activities. A decade ago, RHCP-Bond funded several projects of this nature and, consistent with HUD rules, did not allow any fees. Since then, HUD has reduced their level of development funding, forcing

sponsors to devote more time and energy to securing supplemental funds, and hence to incur greater administrative costs. For this reason the proposed regulation allows a modest fee.

This section allows Section 202 and 811 projects to receive a higher fee in rural areas than in non-rural areas in order to provide an incentive for sponsors to develop this type of project in the more underserved areas of the state.

Section: 8314. Use of Operating Cash Flow

Requirement or Necessity:

The primary topic covered by section is the regulation of profit derived for project operation, after the development period has ended. For MHP, H&S 50675.8(a)(5) says the regulatory agreement shall permit a sponsor to distribute earnings from operation in an amount established by the department and based on the number of units in the development. Operating profit provides a necessary incentive for project development and proper operation. Regulation of operating profit is necessary to prevent profit levels above and beyond what is needed as an incentive for sponsors to develop the housing and operate it appropriately. Neither the HOME statutes nor the JSJFWHG Program statutes expressly address distributed earnings. However, the rental projects funded by these programs do not differ from those funded by MHP and therefore, there is no reason that all three programs should not be subject to the same limitations on distributed earnings.

Documentation, Study or Report: The scheme proposed here is based on that included in the existing MHP regulations, with some significant modifications. CHRP-R regulation section 7684 limits annual distributions to eight percent of the sponsor's actual investment. RHCP Bond regulation section 8089 includes similar language, but limits it to nonprofit sponsors. For-profit RHCP sponsors must choose before loan closing to accept the eight percent overall limit, or to receive no distributions from assisted units, and unlimited distributions from nonassisted units.

Alternatives Considered: One alternative would be to adopt the provisions of the existing MHP regulations, without modification. One major reason for deviating from the MHP model is to conform to regulatory schemes applied by at least some local government entities. It is hoped that aligning HCD's system with that used by these agencies will reduce the costs and delays associated with negotiating differences between these systems during the loan processing stage. Sought after long-term benefits include reductions in sponsor regulatory compliance costs and compliance monitoring costs on the part of HCD and other funding sources.

A second option would be to adopt the rules applied by TCAC to the LIHTC program. TCAC rules limit distributions to the greater of 1) eight percent of operating income or 2) 25 percent of debt service. This type of rule was not adopted for HCD programs because of these programs often fund projects with very low rents, which lead to low operating income, low debt service, and distributions too low to be a strong incentive for sponsors to use the program. The standards in this section offer incentives of fixed amounts per assisted unit, so as not to penalize projects with very low rents.

Prescribed Actions, Procedures, Technologies or Performance Standards: This section sets standards and procedures for calculating and limiting sponsor profit from operations

Fiscal and Economic Impacts: This section limits operating profit and interest payments to HCD.

Discussion:

Subsection (a) sets forth the priority order for use of project operating income.

Subsection (a)(1) specifies that the first priority will be payment of deferred developer fee and various other fees commonly found in tax credit projects, and to the extent that these various other fees have been approved by a local government funding source.

Subsection (a)(2) describes the second priority use of surplus operating revenue: a 50/50 split between the sponsor and HCD. This arrangement is designed to provide the sponsor with a substantial incentive for proper operation, while also generating revenue for HCD. The general idea of splitting surplus cash flow was prompted in part based on the experience of similar federal regulatory arrangements, where housing sponsors had distributions limited to a flat amount, and as a consequence had little motivation to control operating expenses.

Based on a review of loan documents used by several major local jurisdictions, the most common split they use is 50/50. MHP's existing split is 70/30.

Subsection (a)(2)(A) allows HCD to divide its 50 percent share of surplus cash flow with other public entities with similar loan terms. This provision is intended to provide a fair distribution of the surplus among all parties who have a claim similar to HCD. It has been used successfully in MHP and RHCP.

Subsection (a)(2)(B) gives HCD discretion to set the Sponsor's share of cash flow at a level less than 50 percent, to conform with local agency requirements. Where this was done, it would increase the amount of HCD loan payments.

Subsection (a)(2)(C) is intended to address situations where the surplus cash flow is exceptionally rich due to receipt of income that banks and others lenders deem to be too unreliable to take into account when determining the amount of their loans. In these situations, and to the extent the income in question materializes, there is the potential for windfall profit. This subsection authorizes the Department to alter the normal loan repayment terms to capture the extra income.

Subsection (b) is identical to the comparable subsection in the MHP regulations. It prohibits sponsors from accumulating distributions from year to year, on the theory that the basic limits are generous enough, and that sponsors do not need extra compensation if they are unable to take the maximum allowable in a particular year. At the same time, this subsection allows sponsors to deposit funds that they could take as distributions into a project account for distribution in

subsequent years. This later provision is designed to assist sponsors with tax planning, while not increasing the amount distributed.

Subsection (c) prohibits distributions if sponsors have not complied with basic program requirements. It is identical to the comparable provision of the MHP regulations.

Subsection (d) provides that there is no HCD limit on distributions from income from commercial space and nonrestricted units. This space is not aided by program funds, with some minor exceptions, and consequently profits are not limited.

Section: 8315. Subordination Policy

Requirement or Necessity: The Legislature has determined that assistance provided under MHP is to be provided in the form of a loan. By regulation, HCD has determined that HOME assistance to rental housing developments shall be in the form of a loan. For FWHG where federal tax credits will be used, HCD is permitted to make loans. In contrast to a grant, there is an expectation that a loan will be repaid. In FWHG, HOME and MHP, repayment of the loan is secured by a deed of trust recorded on the real property assisted with program funds. For the most part, rental housing developments assisted with FWHG, HOME, or MHP funds also receive loans from other private or governmental entities. Conventional institutional lenders require, as a condition of making their loans, that their deeds of trust be recorded in first lien position, giving them the greatest security in the event of a default and foreclosure sale. It has been HCD's long standing practice to record its deeds and regulatory agreements junior to such conventional lender deeds of trust. It also has been HCD's practice to require that local government lender loan documents be recorded junior to HCD's documents.

The priority of liens on real property generally is determined by the order of recording in the local property records ("first in time, first in right"). However, these priorities can be altered through the use of a subordination agreement. Subordination agreements also are used between lenders to cover other topics such as use of insurance or condemnation proceeds. Historically, the final terms, conditions and wording of a particular subordination agreement between HCD and an institutional senior lender are negotiated on a deal-by-deal basis. However, HCD historically and traditionally has the California Land Title Association (CLTA) form subordination agreement used as a basis to negotiate from. This is because this form is commonly known, understood and accepted in California.

Within the last several years, more funds have become available for rental housing developments under FWHG, MHP and HOME, and there have been more projects using a combination of 4% tax credits and bond financing, in addition to 9% tax credits. This expansion has led to more out-of-state investors and financial institutions becoming involved in HCD-financed projects. When HCD dealt with only a handful of usually California-based institutional lenders and their lawyers, it was able to negotiate a standard subordination agreement acceptable to the particular senior lender for all of its HCD deals. With the expanded number of players, HCD has spent countless hours negotiating the details of subordinations with out of state lenders and their legal counsel. Moreover, many of these lenders have requested concessions from HCD that are not

commonly agreed to here in California. These negotiations have delayed closings and caused frustrations to both HCD and its customers.

Documentation, Study or Report: Based on HCD's experience and practice in administering its rental housing lending programs for over 20 years, HCD has a clear idea of what are the minimal protections necessary to protect the state's interest in its loans. Moreover, the base subordination agreement used by HCD, the CLTA form, is an industry standard in California.

Alternatives Considered: Maintain the status quo. HCD could continue without an articulated subordination policy adopted as a formal regulation. This would mean a continuation of attenuated subordination negotiations with out of state lenders and investors leading to delay in project closings and a potential weakening of the state's security position where it is a junior lender.

Prescribed Actions, Procedures, Technologies or Performance Standards: This section would establish a minimum set of protections to assure that state funds are not unduly jeopardized where HCD is a junior lender.

Fiscal and Economic Impacts: Potentially reduced risk to HCD's funds.

Discussion:

Subsection (a) establishes in regulation for all three programs the statutory direction given to the FWHG program in Health and Safety Code Section 50517.5(d)(4)(D). In effect, this establishes a performance, rather than a prescriptive standard. However, paragraphs (a)(1)-(4) have been added to address specific issues that consistently have arisen primarily with out of state lenders and investors. The CLTA form subordination agreement does not: (1) require a subordinating lender to obtain the senior lender's approval to exercise the junior lender's remedies; (2) prohibit a junior lender from declaring a default when a borrower defaults on the senior lien; (3) nor require a junior lender to agree that acceptance by the senior lender of a deed-in lieu of foreclosure will erase the junior lien.

Subsection (a) exempts from the general requirement projects assisted under two specific federal programs, known as the Section 811 and Section 202 programs. These programs are unique in two respects. First, they provide a long-term operating subsidy as well as capital funding, and thereby make it possible to reliably provide truly affordable housing to households with extremely low incomes. Second, they operate under rules that severely restrict the ability of secondary funding sources to regulate assisted developments and to fully secure their investments (and that would bar HCD participation in these projects without the proposed exemption). The Department has come to the conclusion that the public policy benefits associated with the operating subsidies outweigh the risks inherent in giving up a measure of regulatory control and loan security.

By virtue of its senior position, a senior lender's lien is not jeopardized by the exercise of a junior lender's remedies and/or a junior lender's foreclosure. A junior lender's foreclosure will wipe out the equity of the borrower, and the junior lender will step into the shoes of the borrower

as equitable owner of the property; but the property remains subject to the lien of the senior lender. In contrast, if a senior lender forecloses on its lien, the junior lender's lien is erased and the junior lender receives repayment only to the extent that the proceeds of a foreclosure sale exceed the amount owing on the senior loan. Moreover, in tax credit deals, the limited partner investor requires that the HCD loan be "nonrecourse," meaning HCD may only look to the property as security for repayment of its loan. Thus, if there are insufficient sale proceeds to repay the HCD loan upon foreclosure of the senior lien, HCD is precluded from looking to other assets of the borrower or its partners for repayment.

HCD needs the ability to utilize all of its remedies to forestall a foreclosure by a senior lender that likely would wipe out the HCD lien. It is not just the repayment of the HCD loan that is at stake. Foreclosure also wipes out the HCD regulatory agreement that requires the property to remain in use as affordable housing. If the regulatory agreement is foreclosed out, the HCD-assisted units may all be rented at market rate resulting in tremendous economic dislocation for lower income households. Also, acceptance of a deed in lieu of foreclosure does not have the automatic result of wiping out junior liens as does a foreclosure sale. There is no advantage to HCD in agreeing to such a position, yet some senior lenders still attempt to extract this concession.

Finally, with respect to (a)(3), the form CLTA subordination agreement does provide that a junior lender agrees that the senior loan may be modified, renewed, supplemented or extended. Yet California case law has held that a senior lender cannot take actions that would prejudice a junior lender without the junior lender's concurrence. However, HCD would rather avoid having to file a lawsuit to determine whether or not a senior lender action in some way prejudices HCD. Instead, HCD has had success negotiating language with senior lenders that they will not take these actions without the prior written notice and consent of HCD.

Having these provisions in regulation will reduce the time spent on negotiating subordination agreements on a deal-by-deal basis and will notify potential borrowers in advance of exactly what HCD's subordination policy is. This will allow these potential borrowers to in turn notify other lenders in a transaction at an earlier stage, thus avoiding protracted delay at the end of a loan closing transaction.

Subsection (b) memorializes the existing MHP policy on subordination to local government lenders, as currently specified in section 7306(e). Prior to MHP, HCD had traditionally required local government lenders to subordinate, regardless of the size of their loan. This policy may have prevented some local governments from participating in HCD projects, especially when they were asked to make very large loans, which put more of their resources at risk. To encourage participation by local governments, MHP adopted a regulatory provision allowing HCD to subordinate to local governments that were willing to make loans twice the size of the MHP loan. This provision seems to have worked well in MHP, and hence is being incorporated into these uniform regulations.

Subsection (c) is necessary for clarity and so the terms as used in this section are not confused with the terms used elsewhere in Subchapter 19, or the program regulations for FWHG, MHP or

HOME. It is necessary to deal with both deeds of trust and regulatory agreements since HCD records both as do most local government lenders.

Section: 8316. Leasehold Security

Requirement or Necessity: HOME, FWHG and MHP make loans evidenced by promissory notes the repayment of which is secured by use of a deed of trust recorded as a lien against the real property upon which the rental housing development is located. (See Health and Safety Code Sections 60675.6(b)(1) and 50675.8(a)(6) [MHP], 50517.5(d)(4)(A) [FWHG] and 25 Cal. Code of Regulations Sections 8205(b)(1) and 8214(b)(1) [HOME].) An agreement governing the extended maintenance, use and occupancy also is required to be recorded as a lien against the rental housing development for the same term as the term of the loan (the “regulatory agreement”).

When a person owns all interest in land, it is called “fee” ownership. Sometimes ownership is analogized to a bundle of sticks, and a fee owner owns all the sticks and may sell or lease any of them (e.g., granting of easements or air space rights). The land owner may grant a use right in the form of a ground lease to another person for a certain time period subject to certain conditions. A ground lease is a recognized interest in real property.

It is common real estate lending practice to require that repayment of a loan be secured by a deed of trust recorded against a fee interest in the real property. In the event of a breach of the loan documents, the lender may then foreclose non-judicially, and take ownership of the land and all improvements. Lenders also make loans secured by leasehold interests; however, these loans are much more risky. This is because the borrower does not own the underlying land, and a breach of the lease may wipe out the lease completely and the improvements then become the property of the land owner. If a lender is secured only against the lease and the lease is rescinded, the lender has no security for repayment of its loan. Similarly, a regulatory agreement recorded only against a lease also would be wiped out if a lease was cancelled.

Because loans secured by a lease are inherently riskier than a loan secured by real property, leasehold lenders often require additional protection for repayment of their loans in the form of stricter underwriting standards (e.g., higher loan to value ratios) and higher interest rates and fees. In contrast, HCD’s primary goal in these rental housing developments is that they provide affordable housing for the term of the regulatory agreement (which in most cases is 55 years). Repayment of the loan is of lesser importance. Moreover, HCD is statutorily precluded from increasing the interest rate on its loans.

Because of the extended duration of the regulatory agreement and the desire to maintain these properties as affordable rental housing developments, HCD is extremely apprehensive about the use of long-term leaseholds rather than fee ownership. With such a long-term time frame, events that could threaten the project and the lease, such as a bankruptcy, become a much greater concern. For this reason, HCD chooses to draw its requirements for leasehold security very tightly. The bottom line is that HCD desires to achieve, as nearly as possible, the same security position it would be in had it recorded its deed of trust and regulatory agreement against the fee

interest, rather than a leasehold interest. If prospective borrowers find these provisions onerous, they have the option of obtaining full fee ownership of a site rather than a leasehold interest.

Historically HCD has accepted leaseholds as security but has also required either: (a) that the fee owner of the land agrees to provide HCD with a deed of trust on the fee interest; or (b) that the fee owner/lessor and borrower/lessee agree to a “lease rider” that modifies the lease giving HCD additional security protections. The use of a rider that embodies additional lender protections avoids HCD having to review each lease line by line and attempting to negotiate piecemeal changes.

Even using the above process, in the relatively recent administration of MHP, HCD has become bogged down in tedious negotiations with land owners over the details of lease riders. These negotiations are time consuming and have delayed loan closings. Even where HCD has done its best to follow conventional lending industry practice with respect to the provisions of the lease rider it has encountered entrenched resistance from some land owners.

To avoid these types of protracted negotiations in the future, HCD proposes to inform the public in advance when and under what conditions it will accept a lease as security instead of a fee interest in the real property.

Documentation, Study or Report: 3A Saft, Commercial Real Estate Forms (2d ed. 1999) Leasehold Financing, Sec. 7.08, p. 7-25 – 7-28; conventional lender lease rider equivalent forms; *Valley Investments, L.P. v. Bancamerica Commercial Corp.*, 88 Cal. App.4th 816 (2001) (holding that a ground lease assignee remains liable to lessor after the foreclosure of a leasehold mortgage); “The Basics of Structuring Mortgageable Ground Leases,” Andrew R. Giannella, Ulmer & Berne, LLP, Events and Publications, Real Estate Law Letter, Summer 2001, http://www.e-lawgroup.com/events/newsletters/real/2001/sum_basics.html

Alternatives Considered: HCD considered requiring that the fee interest be subordinated to the leasehold interest. However, the above sources indicated that this was more complicated, and had more pitfalls in the event of foreclosure, than merely requiring that the lease contain the protections proposed in these regulations.

Prescribed Actions, Procedures, Technologies or Performance Standards: None.

Fiscal and Economic Impacts: None

Discussion:

Subdivision (a)(1), (a)(2) sets forth the preferred equivalent to a full fee interest in property – that is, HCD documents are recorded against both the fee interest and the leasehold interest. However, since HCD knows that some land owners will not consent to the recordation of an HCD deed of trust and regulatory agreement on their fee interest, an alternative is provided for leases that meet the requirements of subdivision (a)(2). Also, subdivision (a)(2) sets forth HCD’s policy position that it will not accept a lease that is subordinate to another mortgage on the fee interest. This would be an untenable, risky situation since a breach by the lessor, over

whom HCD has no control, of the senior mortgage could lead to the lessor's loss of the property and the termination of the lease

Subdivision (a)(2)(A) requires that the remaining term of the lease be 90 years. No payments are due on HCD loans (with the exception of the nominal .42% on MHP loans) until the loan becomes due (usually in 55 years). Security for repayment of a loan secured by a leasehold is the residual value in the lease. If a lease terminates at the same time the HCD loan is due, there is no residual value and the borrower would have no incentive to repay the loan. Land leases in the commercial world typically are for 99 years. In HCD's opinion, a loan with a 90 year term would have sufficient residual value at the end of 55 years, when the HCD loan is due, to induce repayment of the HCD loan. Similar to loans secured by a fee, the borrower likely would be able to obtain a conventional refinancing loan secured by the remaining 35 years of the lease with proceeds sufficient to repay HCD's loan (particularly since the property no longer would be encumbered by a regulatory agreement permitting the borrower to charge market-rate rents).

Subdivision (a)(2)(B) is necessary to ensure: that the lessor is aware of the HCD documents; that recording of HCD's documents as encumbrances on the lease in no way breach the lease, and that the lease will in fact secure payment and performance under the HCD documents.

Subdivision (a)(2)(C) is necessary to guard against any use restrictions contained in the lease. Some leases contain provisions regarding use of the property that impair or prevent its use as affordable housing consistent with the provisions contained in the HCD regulatory agreement.

Subdivision (a)(2)(D) is necessary so that, in the event HCD forecloses on a lease that it may step into the shoes of the lessee without triggering a breach of the lease. In addition, HCD does not typically own and manage rental housing developments; it assigns or sells its interest to a nonprofit corporation or local governmental agency experienced in the ownership of affordable housing projects. So, in a work out situation, it is critical that HCD be able to assign its interests to one of these third parties in order to preserve the affordable housing project.

Subdivision (a)(2)(E), (F) are necessary to protect HCD's security interest and the continued viability of the project. These provisions give HCD rights similar to those given to a junior lender whose deed is recorded on the fee. Moreover, as added protection, this provision prevents a lessor and lessee from agreeing to any modification that would impair HCD's security without HCD's approval.

Subdivision (a)(2)(G) is intended to assure that the property will continue to provide affordable housing for the term of the HCD assistance rather than resulting in mere repayment of the loan or grant, and, in the event of destruction of the project, would prevent a lessee from abandoning the property and creating a breach of the lease.

Subdivisions (a)(2)(H) is necessary to avoid HCD's stepping into a lease where the lessee's actions have created a financial liability. If the lessee alone or in conjunction with the lessor were, through its acts or omissions, permitted to incur financial liabilities that would be passed along to any of the lessee's successors in interest, there would be little or no residual value in the lease. This would make it practically impossible for HCD to step in and take over a troubled

project. While this outcome may seem harsh from the lessor's point of view, HCD must protect its interests and it is the borrower's decision to provide a leasehold as security in lieu of full fee ownership.

Subdivision (a)(2)(I). This provision is typically included by commercial lenders to assure that acts or omissions by the lessor or lessee, in the event of either's bankruptcy, do not take discretionary actions that would in any way impair the lease. For example, if the lessor is in bankruptcy, the trustee is permitted to accept or reject leases. This provision would ensure that the trustee would have to accept the existing lease, thereby preserving HCD's security.

Subdivision (a)(2)(J). Under the doctrine of merger, if a lessee acquires the fee, the lease is merged into the fee and extinguished. This provision assures that the lessor and lessee do not arrange for this to occur as a means of wiping out HCD's security.

Subdivision (a)(2)(K). This provision is a necessary convenience for both HCD and the lessor. In the event that HCD were to take over a lease, it is likely that both HCD and the lessor would desire to enter into a new lease reflecting new circumstances. This provision permits this outcome so long as the new lease is not shorter than the remaining term under the existing lease and the terms are substantially the same.

Subdivision (b). In tax credit transactions, it has been the HCD's experience that a nonprofit corporation that owns the land will form a limited partnership in which it is the general partner, and then the corporation will lease the land to the partnership. Since the partnership and the corporation essentially are the same entity, HCD can see no reason that the corporation should not be required to pledge the underlying land as full security for all obligations under the HCD documents.

PROPOSED REGULATION AMENDMENTS – HOME PROGRAM

Section: 8212.2. Uniform Multifamily Underwriting and Program Rules.

Requirement or Necessity: This new section adopts by reference Subchapter 19, the new uniform multifamily regulations. For further explanation of these changes see the ISOR discussion of the multifamily regulations.

PROPOSED REGULATION AMENDMENTS – JSJFWHG PROGRAM

Section: 7204. Eligibility Criteria.

Requirement or Necessity: Historically, subdivision (d)(4)(A) of Health and Safety Code Section 50517.5 required that the recipient of FWHG assistance be the owner in fee of the assisted real property. Section 2 of Chapter 593, Statutes of 2001 (AB 1160) amended this provision to permit HCD to accept "other security acceptable to the department to ensure

compliance with the construction, financial and program obligations.” The purpose of this amendment is to conform existing regulations to this new statutory authority.

Documentation, Study or Report: Based on its more than 30 years’ lending experience, HCD has found that there no security for repayment of a loan for the improvement of real property is equivalent to a lien on the underlying real property. However, HCD has found that a leasehold may provide almost the equivalent security with appropriate protections, as discussed in this ISOR’s discussion for Section 8316 of Subchapter 19 of the uniform regulations.

Alternatives Considered: HCD has expertise and experience in exercising its remedies under deeds of trust and regulatory agreements. However, it does not have experience and expertise in underwriting loans secured by such things as personal guarantees or real property other than that on which the project is located. Moreover, in tax credit deals, the limited partner investor invariably requires that the HCD assistance be “nonrecourse” – that is, HCD may only look to the property for repayment and the partners cannot have any personal liability for repayment. For these reasons, HCD has chosen to consider only leases as an alternative to a fee deed of trust on the property being improved.

Prescribed Actions, Procedures, Technologies or Performance Standards: None.

Fiscal and Economic Impacts: This change may have a positive fiscal impact on potential applicants for FWHG assistance in that they may be able to obtain a long term lease at a cost less than outright purchase of the fee interest.

Discussion: Subsection (a)(3) has been amended to permit leaseholds as alternative security to a fee interest in real property. The language also requires that the underlying lease must permit the borrower to make improvements and comply with program requirements. It would be pointless to make a loan to a lessee borrower under a lease that did not permit the borrower to make the improvements being financed, or to comply with JSJFWHG program requirements. Also, for rental projects, this section adopts the leasehold security rule being adopted in Subchapter 19, Section 8316 of the uniform regulations.

Section: 7234. Operation of Rental and Cooperative Housing Developments.

Requirement or Necessity: The amendments to subsections (b) and (c) are necessary in order to refer the reader to the uniform regulations Subchapter 19, sections 8308 and 8309 dealing with the same subject matter. The content of section 8309 is essentially identical to the deleted subsection (c). For further explanation of these changes see the ISOR discussion of sections 8308 and 8309.

Section: 7239. Uniform Multifamily Underwriting and Program Rules.

Requirement or Necessity: This new section adopts by reference Subchapter 19, the new uniform multifamily regulations. Their applicability is limited to rental housing developments financed by JSJFWHG funds. Other types of projects financed with JSJFWHG funds are not

affected by these changes. For further explanation of these changes see the ISOR discussion of the uniform multifamily regulations.

PROPOSED REGULATION AMENDMENTS – MULTIFAMILY HOUSING PROGRAM

Section: 7300.1. Uniform Multifamily Underwriting and Program rules.

Requirement or Necessity: This new section adopts by reference Subchapter 19, the new uniform multifamily regulations. For further explanation of these changes see the ISOR discussion of the uniform multifamily regulations.

Section: 7301. Definitions

Requirement or Necessity: For general authority, see section 7300. It is essential that critical terms in regulatory language be defined to ensure uniform interpretation and application. Precise definitions help to avoid confusion and dispel ambiguity regarding program requirements, with the result that less customer and program staff time will be necessary to discuss and interpret the regulations. Where feasible, these proposed regulation revisions employ definitions already in use by the department and understood by housing providers who are familiar with real estate lending industry practices and with other HCD programs.

Documentation, Study or Report: The definitions in the current MHP regulations are based on or supplemented by those in several other statutes and regulations. These include section 8076 of the RHCP Bond regulations (CCR Title 25, Division 1, Chapter 7, Subchapter 15), the MHP statutes (H&S section 50675.2), HCD's general statutes (H&S sections 50050-50105), and HCD's general regulations (CCR Title 25, Division 1, Chapter 7, section 6912 et. seq.).

Alternatives Considered: None.

Prescribed Actions, Procedures, Technologies or Performance Standards: None.

Fiscal and Economic Impacts: None.

Discussion:

The deleted definitions are all being moved to Section 8301 of the Uniform Multifamily Regulations. To avoid confusion created in the existing MHP regulations by hiding the definition of "Unit" in the definition of "'Dwelling Unit' or 'Unit'", the definition of "Dwelling Unit or Unit" is being replaced by the definition of "Unit" in the Uniform Multifamily Regulations.

The following is a discussion of definitions that remain in the MHP regulations, and that are being amended:

Subdivision (m): "Eligible households". The proposed revision to the definition deletes the adjective 'Dwelling' as it is used to describe the term Unit. As indicated above, the current

regulations define the terms ‘Dwelling Unit’ and ‘Unit’ as one and the same. It is thought that the use of one term, ‘Unit’, would provide improved clarity to the regulations.

Subdivision (gg): “Special needs populations” Based on program experience and to be more consistent with the California Tax Credit Allocation Committee, two categories of populations are proposed for deletion, single parent households and households enrolled in Welfare to Work programs. Through three application cycles, MHP has not awarded loan funds to serve these two populations. Furthermore, these two population groups do not necessarily have unique supportive service needs that distinguish them as a special needs population, and the single parent household category may not be allowable under fair housing laws.

The term “emancipated foster youth” is replaced by “homeless youth” to reflect legislation enacted in 2002 (and referenced in this definition) that clarified the circumstances under which this general population may be lawfully targeted in rental housing. The other revisions conform the wording of this subsection to the wording in TCAC’s definition of special needs projects (found at Title 24 CCR section 10324(g)(4))

Subdivision (ii): “State Median Income” This term refers to an income level statistic used when determining rent and tenant income limits for MHP-assisted units. Program customers report that references to this statistic are confusing, because other programs, such as the LIHTC, are tied to Area Median Income, not State Median Income. Based on this input, HCD is proposing to continue to use State Median Income as the basis for calculating program income and rent limits, but to express the resulting income and rent limits in terms of the equivalent area median income. To avoid odd increments of area median income, HCD is also proposing to round the area median income level up to the next highest five percent increment. Area Median Income is widely used as a housing affordability standard – one with which housing providers are familiar. HCD believes this will provide clarity to both customers and HCD staff given its familiarity and current usage. Furthermore, using only Area Median Income limits will eliminate confusion from utilizing both Area Median Income limits in conjunction with State Median Income limits.

Section: 7302. Eligible Project.

Requirement or Necessity: The proposed revision does not constitute a substantive change for MHP. It is necessary to avoid losing provisions that are in the existing definition of “‘Dwelling Unit’ or ‘Unit’”. As noted in the justification for Section 7301, this definition is being moved to the Uniform Multifamily Regulations (and the superfluous “Dwelling unit” being dropped in the process). Along with this move, the provisions proposed for addition to Section 7302(a) are being deleted from the definition. They are being added back to Section 7302(a) to make them still apply to MHP.

Documentation, Study or Report: None.

Alternatives Considered: None. The proposed revision does not change the meaning of the regulations. It represents a new location of existing regulation language that is currently found within the definition of dwelling unit.

Prescribed Actions, Procedures, Technologies or Performance Standards: None. The proposed revision does not change the meaning of the regulations. It represents a new location of existing regulation language that is currently found within the definition of dwelling unit.

Fiscal and Economic Impacts: None. The proposed revision does not change the meaning of the regulations. It represents a new location of existing regulation language that is currently found within the definition of dwelling unit.

Discussion: See the Requirement or Necessity discussion.

Section: 7303. Eligible Sponsor

Requirement or Necessity: The deleted subsection (c)(2) is being moved to section 8303 of the Uniform Multifamily Regulations. See the justification for that section for more details.

Section: 7304. Eligible Use of Funds

Requirement or Necessity: The amendments to this section are limited to: (1) revising section references to reflect the movement of some regulatory provisions from the MHP regulations to the new Uniform Multifamily Regulations discussed in the first section of this ISOR and (2) changes to subsection (b)(13) reflecting the determination of HCD's legal office that funds currently available for MHP (general obligation bond proceeds) can be used to capitalize reserves only to the extent that the funds are necessary to meet the program's minimum operating reserve requirement.

Section: 7305. Operating and Replacement Reserves

Requirement or Necessity: The provisions of this section are being move to sections 8308 and 8309 of the Uniform Multifamily Regulations. See the ISOR sections on these two Uniform Multifamily Regulation sections for more information. Also, note that the provisions of the existing section 7305(d) are being deleted rather than moved (except as noted above in connection with section 7304(b)(13)) because of the legal prohibition of using general obligation bond proceeds for most of the uses detailed in 7305(d).

Section: 7306. Type and Term of Loan

Requirement or Necessity: H&S section 50675.1(c) requires HCD to administer the MHP program and to establish the terms on which loans may be made, consistent with the statutes. Section 7306 establishes loan terms. The amendment is necessary to clarify an existing regulatory provision.

Documentation, Study or Report: None.

Alternatives Considered: None

Prescribed Actions, Procedures, Technologies or Performance Standards: None.

Fiscal and Economic Impacts: None

Discussion:

The language proposed to be added to Subdivision (c)(1) clarifies the intent of the existing regulation text. The reference to “the agreement” in the existing text is unclear because there are a number of agreements related to the project. The amendment specifically identifies the agreements that are relevant for this purpose.

Section: 7307. Maximum Loan Amounts.

Requirement or Necessity: MHP statutes (H&S 50675.6(e)) require HCD to establish per-unit and per-project loan limits for all project types.

Documentation, Study or Report: Section 7307(a), which lists basic criteria for establishing loan limits, is nearly identical with section 8081 of the RHCP Bond regulations, and generally similar to section 7677 of the CHRP-R regulations.

Alternatives Considered: None.

Prescribed Actions, Procedures, Technologies or Performance Standards: Section 7307 sets standards for HCD’s determination of maximum loan amounts on a project-by-project basis.

Fiscal and Economic Impacts: Maximum MHP loan amounts will help to determine how much financing a sponsor must obtain from other sources.

Discussion:

Subdivision (a) had previously established that a part of the total loan calculation was to be a base amount for each restricted unit and set the initial base amount at \$20,000. Subdivision (a) provided for periodic revisions to this base amount in order to ensure a sufficient number of applications that met the objectives of the Program. Subdivision (a) has been revised to reflect the most current base amount of \$30,000. Although further revisions to the base amount remain authorized and no change to the text was necessary, publishing the most current base amount is thought to be helpful.

Section: 7308. Interest Rate and Loan Repayments

Requirement or Necessity: The only change to this section is the change in the section reference in subsection (c). The referenced provisions are being moved to the Uniform Multifamily Regulations.

Section: 7310. Unit Standards

Requirement or Necessity: This section is being deleted from the MHP Regulations because its requirements are being moved to section 8304 of the Uniform Multifamily Regulations.

Section: 7311. Tenancy Standards (Renamed “Over-Income Households”)

Requirement or Necessity: H&S section 50675.8(a)(1) says the regulatory agreement for a project shall ensure occupancy of assisted units by eligible households of very low and low income for the term of the agreement. This section interprets and makes specific this statutory requirement.

The purpose of the proposed amendment is twofold: to conform existing regulations to the new uniform multifamily regulation, and to modify program rules pertaining to tenants whose incomes increase after they occupy an assisted unit to the point where they exceed the specified income limit for that unit.

Documentation, Study or Report: None.

Alternatives Considered: With respect to over-income tenants, an alternative would be to not modify the existing MHP regulation. However, the Department believes that the proposed amendment more fairly adjusts rents in accordance with tenants’ ability to pay.

Prescribed Actions, Procedures, Technologies or Performance Standards: This section imposes standards for rent adjustments in MHP projects.

Fiscal and Economic Impacts: This change may have a positive fiscal impact on project sponsors, because it will allow them to charge higher rents to tenants who can afford them.

Discussion:

Existing subsections 7311(a), (b) and (c) have been deleted because the topics they address (tenant selection, rental agreement provisions, and tenant appeal and grievance procedures) are covered by sections 8305, 8306 and 8307 of the uniform multifamily regulations.

The remaining text establishes procedures for situations where an existing tenant’s income has increased since their last annual recertification. Its basic objectives are to keep rents at affordable levels (at approximately 30 percent of actual income), maximize use of units with extremely low rents by households with extremely low income, and generate cash flow for project operations where consistent with the first two objectives.

The new subsection (a) addresses the case where both 1) the increase in income has been substantial -- where, if the household was being qualified as a new tenant, they would be eligible for a unit two income levels above the income level designated for their unit and 2) a rent increase would not run afoul of the rules of the low income housing tax credit rules. Under these circumstances, the sponsor is required to essentially treat the existing tenant as a new tenant, raising their rent to the level that would apply to new tenants with the same incomes. In order to avoid permanent loss of units affordable to households at the lower income level, this subsection also requires the sponsor to make available the next available vacant unit to households with incomes at the lower level.

The new subsection (b) governs instances where existing tenants experience more modest income increases -- ones that put them over the limit for their units, but under the limit that would trigger mandatory rent increases under subsection (a). When these increases occur, this subsection allows but does not mandate the sponsor to increase rents to match increased tenant incomes. For this purpose, it creates, in effect, income bands beyond those that may exist for new tenants, in increments of five percent of area median income. This provision is designed to increase project cash flow while keeping rents at affordable levels.

Section: 7312. Rent Standards.

Requirement or Necessity: H&S 50675.2(a) requires HCD to establish affordable rents for MHP, consistent with TCAC rent limitations. H&S 50675.2(c) defines “maintain affordable rent levels” to require consistency with tax credit program requirements. H&S 50675.4(c) requires a sponsor, as a prerequisite to receiving a loan, to agree to set and maintain affordable rent levels for assisted units.

Documentation, Study or Report: None.

Alternatives Considered: None.

Prescribed Actions, Procedures, Technologies or Performance Standards: TCAC rent determination procedures are adopted by reference.

Fiscal and Economic Impacts: Rent levels determine project revenue, and affect project cash flows and sponsor distributions. Projected operating budgets are examined by HCD to determine that the project can successfully operate at the rents required by MHP.

Discussion:

Subdivision (a) sets parameters for rent determination in general accordance with TCAC requirements. Because Subdivision (c) sets limits for rent increases for existing tenancies that may be more restrictive than TCAC requirements, subdivision (a) has been revised to clarify that

the TCAC requirements apply to initial occupancy and subsequent occupancies by new eligible households.

Subdivision (c) provides that rents may be adjusted no more often than annually in accordance with TCAC procedures used for the tax credit program. Subdivision (c) had provided for a limit on rent increases (beyond the TCAC limit) of 150 percent of the CPI as a protection for tenants not participating in the local prosperity reflected in changes to the Area Median Income. Subdivision (c) has been revised to change the CPI limitation to a uniform 5% limit on rent increases. The 5% limit is thought to be an improvement in administrative ease for both the Sponsor and the Department.

Subdivision (d) is comprised of new text indicating that the Department may permit an annual Rent increase greater than that permitted by this section if the Project's continued Fiscal Integrity is jeopardized due to factors that could not be reasonably foreseen. The new text allows for possible exceptions to the rent increase requirements if, in the Department's view, the continued existence of the project is in jeopardy and rent increases above the required limit would serve to preserve the project.

Section: 7310. Unit Standards

Requirement or Necessity: This section is being deleted from the MHP Regulations because its requirements are being moved to section 8304 of the Uniform Multifamily Regulations.

Section: 7313. Limits on Distributions and Net Developer Fees

Requirement or Necessity: This section is being deleted from the MHP Regulations because its requirements are being replaced by those of sections 8312, 8313 and 8314 of the Uniform Multifamily Regulations. See the justification for these sections for details.

Section: 7314. Limits on ~~Development Costs~~Design Features.

Requirement or Necessity: H&S 50675.7(b)(2) says that development costs for a proposed project shall be reasonable compared to costs of comparable projects in the local area

Documentation, Study or Report: None.

Alternatives Considered: An alternative would be to keep the existing language as it stands. The Department considers the amendments to be an improvement over this alternative because they address site improvement costs, a subject not explicitly covered by the existing regulations.

Prescribed Actions, Procedures, Technologies or Performance Standards: The amendments create additional performance standards regarding site improvement costs.

Fiscal and Economic Impacts: This change is intended to discourage projects that are not cost-effective.

Discussion:

The title of this section is being revised to avoid duplicating the title of section 8311 of the Uniform Multifamily Regulations.

The introductory paragraph of subsection (a) is amended to delete an unnecessary reference to prohibited “new construction” items. The original intent behind the “new construction” reference was to avoid a limitation that would preclude use of program funds on projects receiving historic tax credits. However, the reference to historic tax credits earlier in the paragraph accomplishes this objective, by itself.

The text deleted from subsections (b) and (c) is being relocated to section 8311 of the Uniform Multifamily Regulations.

Section: 7315. Relocation Requirements

Requirement or Necessity: The only change to this section is the change in the section reference in subsection (d). The referenced provisions are being moved to the Uniform Multifamily Regulations.

Section: 7318. Application Requirements

Requirement or Necessity: The only change to this section is the change in the section reference in subsection (b). The referenced provisions are being moved to the Uniform Multifamily Regulations.

Section: 7319. Project Feasibility

Requirement or Necessity: This section is being deleted from the MHP Regulations because its requirements are being replaced by those of section 8310 of the Uniform Multifamily Regulations. See the ISOR section on section 8310 for details.

Section: 7320. Project Selection.

Requirement or Necessity: H&S 50675.7 says “Loans shall be provided using a project selection process established by the department” that meets specified requirements. HCD’s experience indicates that clear and detailed criteria for the competitive evaluation of applications are necessary for several reasons: 1) to show applicants what kind of projects we want to fund,

2) to show applicants that their projects will be evaluated fairly, and 3) to help program staff choose the best available projects.

Documentation, Study or Report: None.

Alternatives Considered: This section could be left as-is. The rationale for each particular change is described below.

Prescribed Actions, Procedures, Technologies or Performance Standards: None.

Fiscal and Economic Impacts: The amendment to 7320(b)(5) will likely reduce the amount of other funds leveraged by MHP, result in fewer projects being assisted by the program, and reduce HCD, sponsor and local agency administrative costs.

Discussion:

The amendment to subsection (a)(5) simply updates the section reference to reflect that the migration of the referenced provisions to the Uniform Multifamily Regulations.

Similarly, the addition of subsection (a)(9) also updates a couple of references. The provisions of 8302 and 8303 currently reside in section 7303 and 7302 of the MHP regulations, but are being moved to sections 8302 and 8303 of the Uniform Multifamily Regulations.

The amendment to subsection (b)(1) modifies the benchmark for measuring the extent to which the project serves households at the lowest incomes. Previously, this benchmark has been state median income. Now it will be the same figure, only expressed in terms of local area median income, and rounded, in accordance with the definition of State Median Income found at 7301(ii). The rationale for this change is discussed the ISOR section for this definition.

The amendment to the first paragraph of subsection (b)(2)(C)(3) clarifies that, for applications for projects restricted to elderly residents, competitive projects presented in market studies to demonstrate a low vacancy rate must be also restricted to the elderly. This requirement is already explicitly stated in (b)(2)(C)(1) for competitive projects presented outside of market studies. The reason for this requirement is that local markets for elderly housing often differ significantly from markets for family housing. To accurately gauge demand for proposed new elderly housing, it is necessary to analyze demand for existing elderly housing.

Subsection (b)(2)(C)(3)(ii) is being amended to correct a wording error. Under the existing regulations, it is unclear what score is to be awarded for vacancy rates exactly equal to three percent. This change specifies the scoring rule for this situation.

The amendments to subsection (b)(5) alter the scale for awarding points for leveraging other funds. Under the proposed new scale, most projects will start to receive points when the ratio between other funds and MHP funds reaches 1 to 1 (compared to 1.5 to 1 under the existing regulations), and receive maximum possible points with a ratio of 3 to 1 (compared to the 3.5 to 1. currently required). This more generous approach to leverage reflects the increased resources

available to the program as a result of the passage of Proposition 46; with extra program funding, there is less reason to leveraged funds in the amounts previously encouraged.

As with the current regulations, these amendments preserve a substantial differential between the leverage expected of rural projects and that expected for projects outside of rural areas. This differential is based on the limited sources of leverage available in many rural areas.

The amendments to subsection (b)(6)(A) are meant strictly to clarify and make more precise the provisions of this subsection.

A new subsection is being added, 7320(b)(7), to reflect the requirements of Health and Safety Code section 50675.13, which was added by SB 1227 of 2002. This statutory section requires that priority points be awarded to projects that qualify as infill or adaptive reuse developments, or that are located in proximity to public transit, public schools, parks and recreational facilities, or job centers. The proposed regulatory language adds to the statute by including definitions for adaptive reuse (“the rehabilitation of vacant or underused commercial or industrial buildings”), and job center (“a concentration of employment opportunities reasonably available to the tenants of the Project”). It also specifies how to determine whether public transit facilities, etc. qualify as being in proximity to the project.

The proposed definition of adaptive reuse is reasonably standard in the industry. It is consistent with the provisions of the statutes governing the Downtown Rebound Program, a special variation on MHP aimed at adaptive reuse, infill and similar project. For example, Health and Safety Code section 50898.1(a), which governs this special program, refers to “the adaptive reuse of vacant or underused commercial or industrial structures.”

The Department looked for a more precise definition of job center, but was unable to locate one that seemed to relate to the intent of the legislation. It expects to have to rely on this general definition, and to make a case-by-case determination about whether projects qualify. The same applies to developed area, which remains without a precise definition.

The TCAC regulations are proposed as the standard for determining proximity because TCAC has used proximity to amenities in their application scoring system for several years, and has spent considerable energy refining their system for measuring it.

Subsection 7320(c) is being added to provide a mechanism for breaking scoring ties. Although the need for a tie-breaker has not yet arisen in MHP, other similar programs have had to make extensive use of their tie-breakers.

Consistent with the statutory mandate to give priority to projects that, among other factors, best serve households at the lowest income levels, the tiebreaker proposed for MHP is a measure of the average income level ceiling for units in the development. The lower the average income level, the more the project meets the goal of the program to serve those at the lowest income levels.

Section: 7321. Legal Documents

Requirement or Necessity: The only change to this section are section reference updates. The referenced provisions are being moved to the Uniform Multifamily Regulations.

Section: 7324. Management and Maintenance.

Requirement or Necessity: The amendment to subsection (d) makes it clear that, after Department approval of the initial management plan, any changes are also subject to Department approval. This requirement was included in Section 7311(a), which is being deleted. This amendment is necessary to preserve the requirement of the current regulations.

Section: 7326. Operating Budget

Requirement or Necessity: The only change to this section is a section reference update in subsection (d).. The referenced provisions are being moved to the Uniform Multifamily Regulations.

Section: 7328. Definitions

Requirement or Necessity: This second definitions section is being deleted. It is unnecessary.

Section: 7330. Amounts and Terms for RWD Loans.

Requirement or Necessity: The amendment to subsection (c) simply conforms this subsection to section 7306 (a). See the justification for the amendment to Section 7306(a) for further details.

Section: 7331. Occupancy and Rent Requirements.

Requirement or Necessity: The amendment to subsection (a) makes the calculation methodology for the income limits recognized by the Rent Write Down component of the program conform to those that, under the amended regulations, will garner competitive points under the main component (and pursuant to section 7320 (b)(1)). See the justification for Section 7301(i) for an explanation of the rationale behind this calculation methodology.

The amendment to subsection (f) conforms this subsection to section 7306(c). See the justification for the amendment to Section 7306(c) for further details